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Prop 2 1/2 as a First Step

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The majority of the taxpayers of Massachusetts make the point that Massachusetts is the land of high taxes — Taxachusetts is the dolorous synonym for the Commonwealth. Proposition 2 1/2 with its caps on the effective property tax rate and on local property tax growth was a result of the high tax syndrome.

In fact, there is some basis for the contention that Massachusetts is a relatively high tax state (Table I). There is also evidence that public spending, both state and local, is, on a per capita basis, higher in the Commonwealth than in the similar states* that provide the basis for our comparisons (Table II).

This may mean that Massachusetts offers more public services to its "constituencies" than do other states similar to the Commonwealth. It might mean that Massachusetts is less efficient. It might mean both. One has no way of knowing for sure, but the evidence does suggest that Massachusetts provides many public conveniences.

The most striking feature of the Commonwealth's revenue structure is its heavy dependancy upon the property tax. In Massachusetts the property tax generates 46.4 percent of all state and local tax revenues. Among the other states in our comparative study, only New Jersey (47.4 percent) and Connecticut (45 percent) have a similar high dependancy on the property tax.+ Massachusetts raised only 10 percent of its tax revenue through general sales; the lowest proportion among the states exhibited in Table I. (The nation as a whole depends on sales taxes for nearly 23 percent of all state and local taxes.) The Commonwealth relied upon income taxation, both personal and corporate, to the same extent (31 percent) as did similar states, excluding Connecticut and New Jersey. It seems that in the post-Prop 2 1/2 era, the Commonwealth should probably diversify its revenue structure.

Before the passage of Proposition 2 1/2, Massachusetts had a high level of public spending. The range and scope of public services provided to its citizens continue to surpass those of many other states; only New York spends more per capita in the public sector, and only California and Michigan even approximate the Commonwealth's per capita expenditures ($1677.74 per capita). The major aspect of the expenditure structure in Massachusetts is the dominance of public welfare outlays in the state. The Commonwealth spends a full *50 percent more* per capita on welfare than the national average. Massachusetts equals the national average for expenditures on education and on health and hospitals. Massachusetts spends *twice* the national average for fire protection.

A good tax system, it is generally argued, should be certain — that is, the taxpayer should easily know or be able to figure his or her liability; progressive, that is, based upon ability to pay; equitable in the sense that persons and enterprises which are substantially similar should have substantially similar tax liabilities; convenient, that is, fit into the normal course of business; economical, that is, not be an undue burden on doing business; and easy to administer.

Unlike taxes on income or its uses, property taxes, especially on households but also on business, do not meet all of these common sense criteria. All tax payments represent diversions of income. Even when a property is sold, its value is converted to cash or to a claim that represents income in some sense. In the extreme case, a property is sold with the proceeds being used to buy another property. Here a case could be made that the income aspect is of such short duration that it scarcely represents a cash flow. And the tax law makes a distinction between capital gain and selling price. But no householders or firms sell off their real property every year, converting the capital gain to tax payment. Yet this kind of logic pervades property tax justification. In truth

*The similiar states are: California, Connecticut, Michigan, New Jersey, New York, Pennsylvania. These states were selected for comparison based on geographical location and industrial structure.

+ When these data were collected in 1979, New Jersey was initiating an individual income tax to lower property taxes. Connecticut has yet to adopt a personal income tax.

Table I Revenue of State and Local Government by Source, 1978-79

	From Federal Gov't	From Own Sources	Taxes	Property	General—Sales	Motor—Fuels, Vehicle, License	Income—Individual, Corporate	Current Charges
CONN	362.05	1378.61	1057.87	266.30	304.02	57.20	314.30	198.16
CONN	299.90	1213.90	1012.97	456.40	236.31	75.22	101.00	109.31
MASS	447.39	1384.90	1176.41	545.97	124.51	48.50	366.56	136.87
MICH	369.26	1380.50	1049.58	375.87	184.94	82.13	342.77	221.23
NJ	292.80	1310.28	1067.47	505.99	149.77	73.23	177.03	161.82
NY	458.69	1665.51	1369.61	481.89	256.66	48.50	435.57	183.06
PENN	295.33	1139.67	921.37	229.77	161.58	69.71	278.78	125.45
US	341.50	1218.15	933.74	295.07	211.53	69.26	222.90	179.32

Source: US Bureau of Census, *Governmental Finances in 1978-1979*, Series GF79, No. 5, US Government Printing Office,Washington DC, 1980.

TABLE II Per Capita State and Local Government Expenditure by Function, 1978-1979

	Total General Expend.	Education	Public Welfare	Health & Hospital	Highways	Police	Fire	Interest on General Debt
CALIF	1651.28	572.90	268.87	138.40	78.47	71.57	32.72	34.02
CONN	1409.70	498.23	190.82	83.69	99.07	53.93	32.17	82.05
MASS	1677.74	547.43	273.91	130.01	99.19	62.40	49.44	73.39
MICH	1670.91	634.39	256.62	155.14	114.71	67.36	24.75	53.38
NJ	1574.30	570.19	191.56	90.21	98.04	66.39	25.26	73.96
NY	1974.99	599.94	302.97	182.67	113.64	79.57	31.69	143.29
PENN	1355.46	477.46	224.82	94.45	89.19	49.10	13.53	81.31
US	1481.26	542.70	183.64	128.20	129.22	55.46	23.38	59.01

Source: US Bureau of the Census, *Governmental Finances in 1978-1979*, Series GF79, No. 5, US Government Printing Office. Washington, DC, 1980.

real property may be a necessary *basis* for earning income. A firm needs a place to do business, offices, factories, and so on. A family needs housing to protect the wage earner and the other family members. But houses are also necessities to retired people, students and other nonworkers. It is difficult to measure the contribution of shelter to the earnings of a household. It is also difficult to estimate the contribution of an office or factory to the income produced by a company. Yet, even though they are officially assessed against wealth, property taxes, so significant in the Commonwealth, are a constant charge against income.

Taxes assessed against the dynamics of economic activity such as sales or income taxes stand in sharp contrast to taxes on property (wealth). The former tend to meet the criteria we suggested earlier, while the latter do not. In a sense, a general sales tax is a tax on the use of income, and as such may be thought to have some of the beneficial features of the income tax.

The Commonwealth through its citizens seems to have several preferences in taxes. First and foremost Massachusetts taxpayers cried "Halt!" to the expansion of property taxes, which are essentially local. The cry of "Halt" was the passage of Proposition 2 1/2, which not only put a cap on property taxes at 2 1/2% of fair market value, an effective tax rate, but also restrained the increase in taxes (set at 2 1/2%) that might have come about by reassessments, and on increases in the tax take from new building. But the preference, in its simplest form, seems to say "Contain property taxes!" The second preference that taxpayers in the Commonwealth seem to hold is that progressive income taxes are undesirable. As an observer, one may point out that the income tax structure of the U.S., both national and state, probably is not as progressive as is generally believed. The so-called loopholes, administrative interpretations and exemptions, in general, tend to reduce the progressive aspects of progressive income taxes in practice.

The passage of Proposition 2 1/2, without the provision of alternative local taxes, results in the need for state and local communities to rethink their priorities in governmental services. It is estimated that the loss in local revenue in fiscal 1982 is of the order of $500 million. The 1981-82 state budget provides $221 million to be distributed to local communities. This amount does not equal the loss in local revenue, but leaves a shortfall about $220 million.*

The tone and temper of taxpayers, as voters, is opposed to any levy of new taxes, at least right now. The legislature and administration reflect perceived voter (taxpayer) attitudes. Recent attitudes and results point to the following trends:

(1) Taxation and hence political power or authority have shifted in part to the State Legislature as a result of the tax cap on localities.

*The formula for the State aid program for 1981-2 comprised the traditional formulas plus an increment of from 2% to 6 % of the loss in local income due to Proposition 2 1/2.

(2) The localities will have to reconsider their expenditure priorities. The obvious places to cut — schools, police, fire — may not be the functions to curtail.
(3) The legislature and administration will have to reconsider the allocations of state aid to localities based upon some measure of local social need.
(4) Items (2) and (3) above will require joint consideration between state and local units since the needs and resources of the various localities differ.
(5) The preceding observations do not necessarily presuppose any new tax levies, state or local. But the commitments of both the state and localities to welfare, schooling, fire protection, police, and health, etc. are so powerful and pervasive in Massachusetts that any curtailment sufficient to release large sums of money is most unlikely. To be sure the restriction — legislated, psychological, or political — of revenue will or at least should engender efficiencies and administrative reform. However, it is most unlikely that efficiences and administrative reform will provide sufficient funds to maintain the end products of social benefit and welfare envisaged in previous budgets. Therefore, new sources of revenue must be sought to secure the Commonwealth's customary level of adequate services. The restraints implicit in Prop 2 1/2 probably will place new tax considerations before the State Legislature. Even a reform of Prop 2 1/2 would have to originate in the Legislature.
(6) If our assumptions about the passage of a progressive income tax are valid, there still is no inhibition on raising the effective rates on the present non-progressive income taxes. Nor is there any inhibition in our argument against levying additional sales taxes. Prop 2 1/2 has reduced the burden of property taxes, bringing them into greater conformity with similar states. The logic of this reduction might suggest the raising of sales taxes to the approximate level of these states.
(7) A suggestive approach might be to consider a variety of taxes which, in their various alternatives, would about equal the tax burdens as borne by the states similar to Massachusetts.
(8) One consideration might be to capitalize the benefits of Prop 2 1/2 to industry and business and to add this to the assessment of the firm's real property. This would require a change in Prop 2 1/2, but not a change affecting households. The dollar benefits of Prop 2 1/2 to a business would be reduced by any additional expenditures undertaken by the firm as a result of the curtailment of local services as a result of Prop 2 1/2. This reduction would occur by the addition of expenses as costs of doing business. If a firm had to increase its security, e.g., police, fire services, or water purification, the net income of the firm would be reduced. When and if the locality again provided such services, net income would be enhanced.

Insofar as Prop 2 1/2 increases the net return to capital, economic theory argues that profits will be increased, and capital will flow into Massachusetts. The inflow of capital would, according to the theory, reduce profits and lower prices. For this to occur the inflow of capital would have to be sensitive to fairly small differences in profits.

In our opinion, Prop 2 1/2 will not attract much capital investment to the Commonwealth. To be sure, some firms may expand their operations or even move to Massachusetts as a result of Prop 2 1/2 (being blind to the costs which Prop 2 1/2 might impose and the tax charges it might generate). But, on the whole, Prop 2 1/2 is unlikely to profoundly affect capital investment inside the Commonwealth. The investment market's futurity is neither so efficient nor certain that investments follow miniscule profit advantages.

Industry, especially new industry, is more likely to move to geographic areas and undertake activities that hold out promises of relatively high and long term profits. Prop 2 1/2, as we have argued, is unlikely to create this atmosphere. Finally, any strategic planner would have to take into account the traditional biases that Massachusetts voters and political parties have for social activities. A good guess is that Prop 2 1/2 is but a step toward a new fiscal and possibly political restructuring of the Commonwealth.

Sophisticated Political Action Benefits Business

by George Schwartz
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In the brief period that President Reagan has held office, his Administration's major thrusts toward smaller government, less regulation, and tax reduction have created euphoria in various business circles. The President's program, trumpeted under the slogan, "A New Beginning," represents the first major attempt to reverse significantly the course of government initiated by Franklin Roosevelt's New Deal almost a half century ago.

While it is likely that this program will achieve significant success in reducing government's negative impact on business, the fact remains that even under a Reagan Administration the federal government will continue to regulate business in many vital ways, and powerful forces in and out of the Congress and the federal bureaucracy will periodically press for additional constraints on business. Moreover, the 1982 Congressional elections could return the Senate to Democratic control, and increase the Democratic majority in the House of Representatives — a development which would make implementation of the Reagan program more difficult.

Under these circumstances veteran observers in the ranks of business are tempering their euphoria and counseling against dismantling the effective apparatus that business has developed for influencing government. Though not always successful, this apparatus has achieved a degree of sophistication in the areas of political intelligence, organization, strategy, and tactics so

that business' ability to influence the federal government now compares favorably with that of any other major special interest group in the country.

This capability, which is of relatively recent origin, did not develop until many top corporate executives realized that government intervention was increasingly constraining their ability to operate viable enterprises, and that the firm, rather than merely adapt, needed to promote its interests by becoming involved in the political process. Once this awareness was achieved, the resources and talent needed to build an effective apparatus for influencing government were allocated in many firms, industry trade associations, and national general business organizations.

It is the rare large corporation that does not have a government relations department and is not represented in the nation's capital by a Washington representative and staff. To learn of any contemplated administrative action or legislation affecting their company, the Washington staff is responsible for monitoring both the Congress and federal regulatory agencies which impact on their firms. In-house talent, including the Chief Executive Officer, as well as outside consultants, if needed, are used to influence legislators and agency officials.

Industry trade associations often perform similar functions, but focus primarily on issues on which the bulk of their member firms are in agreement. National general business organizations such as the U.S. Chamber of Commerce, the National Association of Manufacturers, and the Business Roundtable tend to concentrate on issues that affect business across the board, such as those concerning the environment, occupational safety and health, investment tax credits, and accelerated depreciation.

In recent years, these business efforts to influence the federal government have achieved some major successes such as the defeat of bills to establish a federal Consumer Protection Agency, to permit the closing down of large construction projects even if only one craft went out on strike, and to reform labor legislation. Such business successes are due in large measure to the effective organization and coordination of the business effort, as well as to the use of skillful strategies and tactics.

Promoters of business interests know how the federal government operates, the crucial steps in the formulation and execution of public policy, and the individuals who are important decision makers in the policy process. In the legislative area, for example, business proponents employ diverse strategies and tactics to further business interests. Since persuasion is the major tactic of lobbying, business representatives continually develop relationships with people in power to more readily present them with the business point of view. On major issues such as the Consumer Protection Agency proposal, coalitions are typically used to help plan and coordinate the lobbying efforts of all firms and organizations seeking the same result. When business does not have the votes to defeat a legislative proposal, it employs strategies of delay such as the engineering of Senate filibusters, or the prevention of a House vote by stymieing a bill in the Rules Committee. Conversely, when business does have the votes in Congress, but expects a Presidential veto, business interests will attempt to veto-proof the bill by making it part of another legislative proposal strongly favored by the President.

Business strategists know full well that constituent opinion is important in influencing legislators who are constantly aware of the approach of the next election. For this reason they typically seek grass roots support by attempting to shape public opinion using all media of communications including newspapers and magazines, radio and television, films, interviews and speeches. Additionally, business strategists hire public relations firms to prepare news releases and editorials for distribution to small publications, which often publish copy without indicating the source. Public opinion research is used to measure the impact of these efforts to influence and shape public opinion.

Another useful grass roots mobilization tactic is used by the U.S. Chamber of Commerce, which develops and identifies key resource personnel (KRP) throughout the United States. A KPR is a member of the Chamber who has direct access to a representative or senator. This access may be derived from personal friendship, large campaign contributions, or family relations. The Chamber's strategy is to use these relationships to gain access to legislators, and a friendly hearing for business' point of view.

When necessary, business influence is also focussed on the President. While the President is, of course, not easily accessible, his principal assistants are often available to representatives of major firms or business organizations. Access to these assistants can usually be arranged through the designated liaison person on the White House staff.

Business political action is not restricted to influencing the development and execution of law and public policy. It also seeks to influence the selection, nomination, and election of government officials and members of the judiciary. A major device in this effort is the Political Action Committee (PAC). While it is illegal to contribute corporate funds to political campaigns, a company may form a PAC to solicit funds from employees to be used for this and other politcal purposes. Typically, PAC contributions to political campaigns aim to aid the election of legislators friendly to business, a particular industry, or a specific firm; make a favorable impression on a powerful legislator; or help develop relationships that will enable corporate representatives to have better access to legislators. PACs often contribute to candidates of both major political parties.

Not only do business strategists develop and use appropriate political strategies and tactics, but they are also sensitive to changing intergovernmental relations and responsibilities. In this connection close attention is being paid to the implications for state government of the President's program to reduce the power of the federal government. This element of his program is known as the "New Federalism" and involves sloughing off those functions currently performed by the federal government which the President asserts should either not be performed by government at all, or should be the responsibility of either state or local governments. To the extent that the President's "New Federalism" shifts reg-

ulatory functions that significantly influence business to state and local government, political activities by business at these governmental levels must be brought up to the strength and sophistication of those practiced on the federal scene.

The July 1981 Massachusetts Economic Policy Analysis (MEPA) Long Range Model Forecast

by
George Treyz and Roy E. Williams*

In this report we will present a long range forecast for Massachusetts in addition to our usual short term forecast. The outlook for the Massachusetts economy in 1981 is for employment growth at about the same rate as growth in the labor force. This should mean an unemployment rate near six percent for the rest of the year. In 1982 and 1983 employment is forecast to grow slightly more than the labor force. This leads to a decrease in the predicted unemployment rate to 5 percent by 1983.

Recently released data show that Massachusetts wage and salary disbursements at the end of 1980 grew more slowly than employment gains in that quarter would have led us to expect. This is due to the persistence of a slower rate of wage growth in Massachusetts than in the nation. In this forecast, as inflation decelerates from a 1981 rate of 10.9 percent to a 1983 rate of 7.9 percent, it is predicted that real per-capita disposable income will increase by about six percent during these three years.

The long range forecast shows continued but decelerating growth for Massachusetts over the longer term. The growth in the early part of the 1980's stems from continued expansion of industries in which Massachusetts has a more than proportionate representation and from a continuing response to the substantial reduction in Massachusetts' relative production costs in the late 70's and early 80's. This reduction in relative costs is mainly due to lower wage growth in Massachusetts than in the rest of the United States in the period since 1975. After the above factors have run their course, Massachusetts is forecast to resume its decline in employment, population and aggregate real income relative to the rest of the United States. However, these declines are forecast to be at much slower rates than in the last three decades, so that real per capita incomes relative to the U.S. will decline only slightly.

By the 1993-95 period real disposable income per capita in Massachusetts is predicted to be 15.6 percent higher than in the 1978-80 period, a relatively slow growth rate by historical standards. Real income per worker increases only 5.5 percent, while the rest of the per capita growth reflects a nine percent increase over the period in the proportion of workers in the over-fifteen population (the "employment rate"). This slowdown in growth reflects a slowdown in the national economy. Even though DRI forecasts some improvement in productivity growth compared with the dismal record of the seventies, the growth in real GNP is forecast to be very slow, primarily for demographic reasons. Since the post-war baby boom cohort has nearly finished entering the labor force, the most important constraint on economic growth is expected to become labor supply.

The long-term forecast for Massachusetts shows no future recessions explicitily because it is based on a trend national forecast rather than on one that predicts possible future recessions. DRI describes its TREND-LONG forecast as "depicting the *mean* of possible paths that the economy would follow if subject to no major disruptions." This description applies as well to the MEPA forecast for Massachusetts. We will undoubtedly experience future cyclical episodes but it would not be realistic to attempt to predict their timing and magnitude.

Since the early decades of this century, Massachusetts has been undergoing a metamorphosis as the textile and apparel and leather goods industries have left and other industries have grown in relative importance. This transformation has accelerated in the last two decades. Over that period nonelectrical machinery and instruments exports have increased from about ten percent of Massachusetts exports to the rest of the U.S. to over fourteen percent at present. Retail trade and services have also grown as a proportion of the Massachusetts economy. At the same time the nondurable goods industries of Food Processing, Textiles, Apparel, Paper, Rubber and Leather have all decreased substantially as shares of the Massachusetts export base.

One of the consequences of this change has been to make the Massachusetts economy slightly less sensitive to cyclical dips than it used to be. Computer simulations carried out by the MEPA project show that despite the conventional wisdom that durable goods industries are cyclically sensitive, the Massachusetts economy would have experienced declines about ten percent less severe during national recessions in the last decades if we had had our current industry mix instead of the one more weighted toward nondurables that we actually had.

Finally, it should be noted that long range forecasting pushes the techniques used in computerized forecasting to their extreme. Unforeseen events in the past such as the energy price shocks of the last decade have reshaped our economy dramatically. It is not unlikely that some unexpected future development or event will have a substantial effect on the Massachusetts economy. Thus, this forecast should be used as a baseline guide to what the future would look like in the unlikely case that nothing unusual happens between now and 1995.

*Director and Associate Director, respectively, of the MEPA project. Economics Department, University of Massachusetts, Amherst, MA 01003. (Tel. 413-545-0915). Technical support was given by staff of the Massachusetts Division of Employment Security. Support from the Legislative Science Resource Office, the Department of Public Welfare, the Executive Office of Economic Affairs, the Division of Employment Security, the Executive Office for Administration and Finance, and Massport. National inouts from CONTROL052581 and from TRENDLONG0681 from Data Resources, Inc.

July Long-Range Forecast

Summary Report
Massachusetts Economic Policy Analysis Model
(Seasonally Adjusted Annual Rates)

	1981-83	1984-85	1987-89	1990-92	1993-95	1981	1982	1983
Employment—Nonag. W. & S.	2750	2921	2987	3027	3081	2690	2748	2811
% Change	2.0	2.0	.7	.4	.6	1.6	2.1	2.3
Manufacturing	688	710	702	695	694	672	690	702
% Change	1.1	1.1	-.4	-.3	-.0	-.2	2.6	1.8
Non-Manufacturing	2062	2211	2286	2332	2386	2018	2058	2109
% Change	2.3	2.4	1.1	.7	.8	2.2	2.0	2.5
Unemployment Rate	5.4	4.9	5.7	5.8	5.7	5.8	5.4	5.1
Employment Rate Index*	110.5	115.0	115.9	116.6	117.6	109.1	110.4	112.1
% Change	.9	1.3	.2	.2	.3	1.1	1.2	1.5
Relative to U.S. Index*	106.6	107.9	107.1	106.7	107.1	106.6	106.3	106.9
Rate of Wage Change	8.7	9.0	8.6	8.2	7.7	9.4	8.7	8.3
Wage Index Rel. to U.S.*	94.2	94.8	94.8	94.2	93.9	94.0	94.3	94.3
Avg. Weekly Hours in Mfg.	40.3	40.3	40.3	40.4	40.4	40.1	40.3	40.4
Rate of Price Inflation	10.3	8.0	8.1	7.7	6.8	10.9	8.4	7.9
Relative to U.S. CPI*	96.6	96.9	97.2	97.2	97.1	96.7	96.5	96.5
Personal Income (mil$)	71441	96778	128158	166421	211049	64087	71368	78867
% Change	11.5	10.6	9.8	9.1	8.2	12.0	11.4	10.5
Disposable Income (mil$)	60149	82399	108333	139756	176251	53500	59992	66956
% Change	11.6	11.1	9.6	8.9	8.0	11.7	12.1	11.6
Real Per Cap. D.I. Index*	108.5	115.5	118.4	120.7	123.3	105.8	108.4	111.2
Relative to U.S.*	102.5	102.3	101.5	101.0	100.9	102.4	102.7	102.5
Rel. Business Cost Index*	96.6	97.0	97.1	96.8	96.6	96.6	96.6	96.7
Manufacturing*	95.6	95.9	96.0	95.8	95.6	95.6	95.6	95.7
Non-Manufacturing*	97.1	97.4	97.6	97.2	97.0	97.0	97.1	97.1

*Indexes equal 100 in calendar 1973.

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